



No. 76-1794

**IN THE SUPREME COURT OF
THE UNITED STATES**

OCTOBER TERM, 1976

In the Matter of

THE NEW YORK, NEW HAVEN AND
HARTFORD RAILROAD COMPANY,
DEBTOR

JACOB D. ZELDES, Successor Indenture Trustee under The
New York, New Haven and Hartford Railroad Company's
General Income Mortgage Dated as of July 1, 1947,
Petitioner

v.

MANUFACTURERS HANOVER TRUST COMPANY, Former
Indenture Trustee under The New York, New Haven and
Hartford Railroad Company's First and Refunding Mortgage
Dated as of July 1, 1947; and

RICHARD JOYCE SMITH, Trustee of the Property of The
New York, New Haven and Hartford Railroad Company, Debtor,
Respondents.

**BRIEF OF RICHARD JOYCE SMITH,
TRUSTEE OF THE PROPERTY OF THE DEBTOR,
IN OPPOSITION TO CERTIORARI**

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July 15, 1977

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STATUTE PRIMARILY INVOLVED

Section 77(c)(12) of the Bankruptcy Act, 11 U.S.C.
§ 205(c)(12)(1970), in the form set out by Petitioner (Petition at 3) was amended, effective as to these proceedings on
February 5, 1976.

The amendment to § 77(c)(12) was effected by § 618(b) of the Railroad Revitalization and Regulatory Reform Act of 1976, Pub. L. No. 94-210 (Feb. 5, 1976), which, in pertinent part, provides:

The powers and duties of the Commission under section 77 of the Bankruptcy Act (11 U.S.C. 205), with respect to a railroad in reorganization in the region which conveys all or substantially all of its designated rail properties to the [Consolidated Rail] Corporation or a subsidiary thereof, or to profitable railroads in the region, pursuant to the final system plan, and the requirement that plans of reorganization be filed with the Commission, shall cease upon the date of such conveyance. The powers and duties of the Commission under section 77 of the Bankruptcy Act shall also so terminate, as of the date of enactment of this paragraph, with respect to any railroad in reorganization under such section 77 but not subject to this Act which (1) does not operate any line of railroad, and (2) has transferred all or substantially all of its rail properties to a railroad in reorganization in the region which was subject to this Act prior to the date of enactment of this paragraph. Thereafter, such powers and duties of the Commission shall be vested in the district court of the United States which has jurisdiction of the estate of any such railroad in reorganization at the time of such conveyance.

COUNTERSTATEMENT OF QUESTION PRESENTED

Did the Reorganization Court, as a court of equity, reasonably exercise its discretion, in light of its findings as to a conflict of interest and other matters, in conditionally awarding compensation to, and in reimbursing expenses of, the indenture trustee?

STATEMENT OF THE CASE

Manufacturers Trust Company (the "Trust Company") had been the Trustee under the indenture securing the First and Refunding Mortgage Bonds (the "NH Bonds") of The New York, New Haven and Hartford Railroad Company, Debtor (the "New Haven") from its execution in 1947. The Trust Company merged with the Hanover Bank ("Hanover") shortly before the New Haven entered reorganization in 1961 to form Manufacturers Hanover Trust Company ("Manufacturers"). Hanover had served as a trustee under mortgage indentures of The New York Central Railroad Company ("NY Central") since 1897. In particular, it had since that time been indenture trustee under the mortgage securing the NY Central's so-called Gold Bonds due 1997.

Manufacturers continued as indenture trustee for both the NH Bonds and the Gold Bonds. NY Central merged in 1968 with The Pennsylvania Railroad Company ("Pennsylvania") to form Penn Central Transportation Company ("Penn Central"),¹ and the Gold Bonds became a Penn Central obligation.

The New Haven has been in reorganization under § 77 of the Bankruptcy Act since July, 1961, and the NH Bonds have been in default since that time. Circuit Judge Robert P. Anderson has presided over the New Haven's reorganization in the United States District Court for the District of Connecticut ("Reorganization Court") since the inception of the reorganization, first as a district judge and since 1964 by designation. Respondent Richard Joyce Smith (the "New Haven Trustee") was one of three reorganization trustees originally appointed; since 1969 he has been the sole trustee.

Penn Central has been in reorganization under § 77 since June, 1970, and the Gold Bonds have been in default since that time.

¹ Immediately following the merger, the company was known as Pennsylvania New York Central Transportation Company; later, its name was changed to Penn Central Company and then to Penn Central Transportation Company.

As the profitability of rail operations in the East ebbed or ceased entirely, liens on non-rail properties mortgaged to secure railroad bonds became increasingly important. The security for the Gold Bonds includes mortgages of Penn Central's (originally NY Central's) interest in valuable commercial properties along Madison, Vanderbilt, Park and Lexington Avenues in the vicinity of New York's Grand Central Terminal (the "GCT Properties").

For over 100 years, the New Haven enjoyed contractual rights to enter New York City over NY Central's tracks and to share its terminal facilities. The New Haven participated with NY Central in the development and operation of the GCT Properties, with the net income being applied to reduce the costs of operating Grand Central Terminal.²

As a result of action taken by the New Haven Trustee, the Interstate Commerce Commission (the "ICC") conditioned its approval of the merger of NY Central and Pennsylvania on the New Haven's inclusion in its merged system.³ Following the Court's affirmance of the merger, the New Haven carried out the inclusion, i.e. the conveyance of its properties to Penn Central, on December 31, 1968, although the consideration for the conveyance remained to be adjudged.

The inclusion constituted a first step in the New Haven's plan of reorganization under § 77. Formally, the New Haven's assets were conveyed to Penn Central free of lien, and, by order of the Reorganization Court, the lien of the NH Bonds attached to the consideration to be received from Penn Central. The second step in the plan provided for the treatment of claimants based on the consideration to be received from Penn Central. Through its counsel, Simpson, Thacher & Bartlett,

² It was not until the mid-1960's that the income from the GCT Properties exceeded the cost of operating the Terminal, thereby making significant the issue of New Haven's interest in the excess income.

³ Pennsylvania RR.—Merger—New York Central RR., 327 I.C.C. 475 (1966); Penn Central Merger Case, 389 U.S. 486 (1968).

Manufacturers participated actively in the litigation with Penn Central over the price to be paid by Penn Central, including litigation over the nature and value of the New Haven's interest in the GCT Properties. Judge Anderson found that Manufacturers was among those to be credited, not only with increasing the purchase price, generally, above that fixed by the ICC, but also with securing a favorable judgment concerning the New Haven's rights in the GCT Properties.⁴

This valuation litigation culminated in the *New Haven Inclusion Cases*,⁵ decided by the Court only eight days after Penn Central had itself filed for reorganization under § 77. In the subsequent proceedings on remand before the Reorganization Court, a principal issue was the nature of protection for the New Haven's rights against Penn Central in view of the latter's bankruptcy. It was pleaded and argued by the New Haven Trustee with the support of Manufacturers (and others) that an equitable lien should be declared to exist on those former New Haven properties transferred in fee, and that Penn Central should be deemed to hold the New Haven's former 50% interest in the GCT Properties in constructive trust for the benefit of the New Haven.

This position had the effect of being an indirect attack upon the priority and extent of the lien on the GCT Properties securing the Gold Bonds. Manufacturers then was faced with the involuntary dilemma and conflict of its respective indenture trusteeships for the NH Bonds and the Gold Bonds. In its capacity as trustee under the Gold Bond indenture, but through counsel other than Simpson, Thacher & Bartlett, Manufacturers joined with Penn Central's reorganization trustees in opposing the constructive trust and the New Haven's related claims against Penn Central. Manufacturers thus openly appeared before Judge Anderson on both sides of the same issues.

⁴ *In re New York, N.H. & H. RR.*, 421 F. Supp. 249, 269 (D. Conn. 1976).

⁵ 399 U.S. 392 (June 29, 1970).

The constructive trust and the related relief sought by the New Haven Trustee, and supported by Manufacturers in its capacity as indenture trustee for the NH Bonds, were granted by Judge Anderson. However, the Court of Appeals for the Second Circuit in an appeal taken by the Penn Central reorganization trustees, with the support of Manufacturers in its capacity as indenture trustee for the Gold Bonds, reversed on jurisdictional grounds.⁶

Manufacturers filed a petition with Judge Anderson on June 21, 1971, to resign as indenture trustee of the NH Bonds, after having sought futilely since mid-1970 to find a trust company willing to act as indenture trustee. It proved impossible to find a corporate trustee and Judge Anderson appointed an individual. Manufacturers filed a petition with the Penn Central reorganization court on July 17, 1975, resigning as trustee under the Gold Bonds.

The question of the impact of its dual role arose in the case at bar in connection with a petition filed by Manufacturers under § 77(c)(12) of the Bankruptcy Act with the Reorganization Court for expense reimbursement and compensation from the New Haven estate.⁷ In a statement of position which he then filed with the Reorganization Court, the New Haven Trustee raised the issue of Manufacturers' conflict, and took the position that the Reorganization Court had discretion whether and to what extent Manufacturers should be censured through

⁶ The merits of these issues remain to be determined.

⁷ The Railroad Revitalization and Regulatory Reform Act of 1976 withdrew the ICC's jurisdiction under § 77 relating to the New Haven's reorganization, effective February 5, 1976.

The proceedings before the Reorganization Court took place in May and June of 1976. Initially, the ICC had agreed that it had no jurisdiction over Manufacturers' petition in light of the recent legislation. Following entry of the Reorganization Court's judgment, the ICC changed its position and appealed to the Court of Appeals for the Second Circuit on the ground that the withdrawal of jurisdiction was prospective only. However, before the case was heard by the Second Circuit, the ICC again reversed its position and withdrew the appeal.

a determination of allowances. The New Haven Trustee pointed out that, in large measure, the fee sought by Manufacturers was to be passed through to its counsel, Simpson, Thacher & Bartlett, who had acted in a wholly professional manner in the premises, free from any conflict.

Judge Anderson found that Manufacturers had acted under a conflict. He determined that the allowance to Manufacturers should reflect this finding, but should also take into account the valuable services provided by Manufacturers and Simpson, Thacher & Bartlett during the period from 1961 to 1970. Thus, he made an award to Manufacturers in respect of legal fees that was consistent with the uncontroverted view that Simpson, Thacher & Bartlett should not be penalized, and reimbursed Manufacturers for other out-of-pocket expenses, but postponed compensation to Manufacturers for its own services pending a determination of whether its conflicted activities indeed injured the New Haven estate. This ultimate determination would be accomplished through a formula which would limit Manufacturers' allowances to a percentage (a maximum of $\frac{1}{4}$ of 1%) of future payments received by New Haven from Penn Central.⁸

Petitioner herein, himself a successor indenture trustee, together with Lawrence W. Iannotti, successor indenture trustee to Manufacturers, appealed to the Court of Appeals for the Second Circuit.

The Second Circuit, by a unanimous opinion and decision affirmed the Reorganization Court.

The Court of Appeals observed at the outset of its opinion, that:

This is the case of the wise and comprehending chancellor. (Appendix to Petition at 3a)

⁸ The amount of future payments is the subject of a settlement between the New Haven Trustee and the Penn Central Trustees which is incorporated in a plan of reorganization for Penn Central which is now sub judice.

ARGUMENT

Petitioner relies on apparently alternative arguments in seeking to have the Court grant certiorari. First, he argues that the decision below is in conflict with existing law. Second, he argues that this matter warrants decision by the Court in order to establish the law in what he contends is an important area of wide applicability.

Contrary to these arguments, the New Haven Trustee submits that the decision below neither fails to follow decisions of the Court nor conflicts with decisions of other Courts of Appeals and, in any event, is so totally the product of a complex and unique factual situation that it cannot be deemed to have decided a question of law so important that it should now be determined by the Court. Moreover, the New Haven Trustee is both satisfied with the fairness and equity of the decision below and concerned that the plenary review sought by Petitioner exposes the New Haven estate to the burden of costs of both sides from unnecessary and expensive further appellate proceedings.

I. The Decision Below Does Not Conflict with Prior Decisions of This or Other Courts.

Petitioner cites a number of decisions by Courts of Appeals other than the Second Circuit that are alleged to be in conflict with the decision below.⁹ To be sure, these cases reach decisions which are different from that reached in this case, but they do so based either on readily distinguishable factual grounds or on an inapposite statutory requirement. Cases¹⁰ decided under § 249 of the Bankruptcy Act, 11 U.S.C. § 649, which absolutely bars compensation to fiduciaries in a Chapter X proceeding who have traded in the debtor's securities, a matter not in issue here, are not relevant to the instant issue.

⁹ With limited exception, these cases were not cited to the Court of Appeals below.

¹⁰ *Wolf v. Weinstein*, 372 U.S. 633 (1963); *In re Inland Gas Corp.*, 309 F. 2d 176 (6th Cir. 1962); *In re Walchef Development Corp.*, 388 F. Supp. 1064 (S.D. Cal. 1975).

The cases cited by Petitioner do not support any conflict in decisions as alleged by him. Petitioner's position, it appears, is founded solely on his hypothesis that *Woods v. City National Bank and Trust Co.*, 312 U.S. 262 (1941), established an "inflexible rule of equity" (Petition at 14), which absolutely prohibits an allowance of compensation to a fiduciary involved in a conflict of interest, no matter what the extenuating circumstances.

In *Holmberg v. Armbrecht*, 327 U.S. 392 (1946), the Court stated that "[e]quity eschews mechanical rules; it depends on flexibility." *Id.* at 396. Although that was not stated in the context of a conflict of interest, the underlying principle is applicable to this case.

The lack of flexibility in certain areas of jurisprudence was, of course, the key factor in the evolution of courts of chancery. The Court of Appeals obviously construed this case itself to be a testimonial for preserving flexibility, referring to "the wise and comprehending chancellor." And, indeed, Petitioner himself agrees with that characterization. (Petition at 19).

Notwithstanding that agreement, however, Petitioner contends that the *Woods* case withdrew from Judge Anderson the discretion to view Manufacturers' fee request in the context, *inter alia*, of the substantial benefit which Manufacturers had conferred on the New Haven estate prior to 1970, the extraordinary and involuntary nature of the conflict, the primary role played by the Penn Central trustees in opposing the New Haven interests, and Manufacturers' attempt to avoid leaving any bondholders without an indenture trustee and to insulate its decision-making process from the conflict.

Judge Anderson has sat in these proceedings since the New Haven entered reorganization in 1961 and has first-hand, actual knowledge of the relevant facts bearing on Manufacturers' conflict and conduct. Petitioner contends that, sitting as a court of equity, Judge Anderson was nevertheless bound by the *Woods* case to eschew what he considered to be the equitable result, and inflexibly to deny any compensation and expense reimbursement.

Unless the Court agrees with Petitioner's hypothesis that the Woods case requires inflexibility, the decision below neither conflicts with prior decisions of this Court nor with the decisions of other Courts of Appeals.

II. The Decision Below is Based on a Unique Factual Situation.

Petitioner argues that the decision below "will set [a] dangerous precedent for railroad reorganizations and all bankruptcy law." (Petition at 15). It is submitted that, on the contrary, the unique factual background of this case makes it essentially sui generis. It is difficult to believe that it should now be assumed that there will ever be another case like it.

Given the limitations on the obligations and responsibilities of trustees under mortgage indentures, a conflict of the nature herein could again arise only in a situation where: (1) two otherwise unrelated issuers have an interest in the same piece of property and each company secures its public issue of securities with a mortgage lien on its interest in the property; (2) both companies default in their obligations secured by such mortgages; (3) a conflict develops between the two companies over their respective interests in the subject property; (4) the event giving rise to an active conflict shall not have occurred until after both companies had defaulted; and (5) the indenture trustee finds it impossible to secure a successor trustee for one of the mortgages in a timely fashion. In short, the considerations with which Judge Anderson was faced will not be repeated unless the same person, as indenture trustee for two different companies, becomes engaged in litigation over conflicting security interests in the same property in a situation where the conflict could not reasonably have been anticipated until both obligors became bankrupt. While history may repeat itself, that possibility is sufficiently remote that the immediate need for the Court to establish the "standards" referred to by Petitioner (Petition at 15) is without adequate support.

III. Further Appellate Proceedings are Not in the Interest of the New Haven Estate.

It was the New Haven Trustee who first raised the issue of Manufacturers' conflict and its appropriate treatment in the allowance of compensation. He did so in his reorganization trustee's capacity as a fiduciary for all creditors of the estate, with a view toward assuring fair and equitable treatment for all persons having an equity in the estate's limited assets. The New Haven Trustee considers that Judge Anderson's determination achieves that goal and submits in support that the panel of the Court of Appeals unanimously agreed with the Reorganization Court's analysis of the applicable legal principles. Further appellate review is unnecessary to protect any interest in the estate, and would burden the most junior interest in the estate with additional costs.

Petitioner claims that Manufacturers' fees would diminish "the funds available to meet the New Haven estate's obligations to the holders of its general income bonds" for whom Petitioner is indenture trustee. (Petition at 21 n.10). Like payment of any other administration charge, that is true. But such an effect does not diminish equity's concern whether direct beneficiaries of an increase in the estate, achieved in significant part by Manufacturers, should be allowed to avoid an appropriate allowance of fees. That Manufacturers' efforts in the litigation over the New Haven's interest in the GCT Properties may be a key to the existence of any equity for the general income bonds should, in view of its conflict, not necessarily produce compensation for Manufacturers, but, conversely, the existence of a conflict should not bar a court of equity from a determination that expense reimbursement and compensation may be warranted notwithstanding the conflict.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted,

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